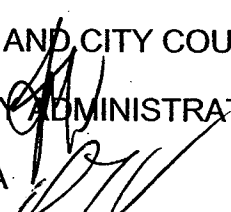



Council/Agency Meeting Held: _____		City Clerk's Signature _____
Deferred/Continued to: <u>1-5-2009/2-2-09</u>		
<input type="checkbox"/> Approved <input type="checkbox"/> Conditionally Approved <input type="checkbox"/> Denied		
Council Meeting Date: 12/15/2008	Department ID Number: FN 08-007	

## CITY OF HUNTINGTON BEACH REQUEST FOR CITY COUNCIL ACTION

**SUBMITTED TO:** HONORABLE MAYOR AND CITY COUNCIL MEMBERS

**SUBMITTED BY:** FRED A. WILSON, CITY ADMINISTRATOR 

**PREPARED BY:** DAN T. VILLELLA, CPA 

**SUBJECT:** AN ORDINANCE OF THE CITY OF HUNTINGTON BEACH  
AMENDING CHAPTER 5.08 OF THE HUNTINGTON BEACH  
MUNICIPAL CODE RELATING TO LICENSING PROCEDURES

Statement of Issue, Funding Source, Recommended Action, Alternative Action(s), Analysis, Environmental Status, Attachment(s)
--

### **Statement of Issue:**

In March 2008, the Finance Department began auditing and notifying licensed real estate professionals of the business license requirement of the City of Huntington Beach. On June 16, 2008, the City Council passed an "H item" directing staff to suspend auditing activity for 90 days and to evaluate the business license ordinance relating to real estate professionals and establish updated code language if necessary. On September 15, 2008, following a Study Session, City Council directed staff to prepare an update to the Huntington Beach Municipal Code allowing for specific exemptions from the business license tax for real estate sales agents. Additionally, City Council directed staff to review the refunding of taxes and fees paid by real estate agents that obtained a business license.

### **Funding Source:**

Approval of this action will result in a reduction of general fund revenue for fiscal year 2008/09 of approximately \$22,000 through refunds of taxes and fees paid in prior years.

### **Recommended Action: Motion to:**

- 1) Adopt Ordinance No. 3817, "An Ordinance of the City of Huntington Beach Amending Chapter 5.08 of the Huntington Beach Municipal Code Relating to Business License Procedures."
- 2) Approve and authorize staff to refund taxes and fees paid by real estate agents to the city in tax year 2006, 2007, and 2008.

## REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: 12/15/2008

DEPARTMENT ID NUMBER: FN 08-007

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### Alternative Action(s):

- 1) Adopt Ordinance No. 3817, *"An Ordinance of the City of Huntington Beach Amending Chapter 5.08 of the Huntington Beach Municipal Code Relating to Business License Procedures."*
- 2) Approve and authorize staff to refund taxes and fees paid by real estate agents to the city in tax year 2006, 2007, and 2008.
- 3) Approve persons licensed by the California Department of Real Estate and have their license placed with a broker outside the City of Huntington Beach, shall not be subject to the business license tax.

### Analysis:

In November 2006, the City of Huntington Beach Finance Department, utilizing data from the Franchise Tax Board, began notifying businesses operating in the city without a business license that they were required to obtain a business license. In October 2006, City Council was notified of the Franchise Tax Board audit process and the professions to be targeted, including real estate agents (Attachment 2). Letters to real estate agents and brokers were mailed in March 2008 (Attachment 3). The Orange County Association of Realtors contacted the city to request a meeting on the business license requirement for real estate agents. On April 1, 2008, city staff met with members and representatives from the Orange County Association of Realtors and the Pacific West Association of Realtors. At that meeting, it was agreed that enforcement of the tax liability would be suspended for 60 days, while the city reviewed the argument presented by the Realtors (Attachment 4).

The position of the Realtors is that an agent is required to work for a licensed real estate broker. A real estate agent is supervised by a broker and must always work under the supervision of that broker. An agent cannot work for two brokers at the same time. The broker is responsible for any errors and omissions of the agent. The sales agent is acting on behalf of the broker with limitations of rules imposed by the Department of Real Estate. Only a broker may change the listing of an agent in a Multiple Listing Service. If an agent leaves the employ of a broker, any listings will remain with the broker unless the homeowner allows a broker to broker transfer. Also, the issue of independent contractor status is unique to real estate agents due to the nature of representing buyers and sellers in a commission based transaction (Attachment 5).

On September 15, 2008, during a City Council Study Session on the city's authority to require a real estate sales agent to obtain a business license, the City Council directed staff to prepare an ordinance reflecting the proposed additional language that would exempt real estate agents from the business license tax requirement. City Council also directed staff to refund any business license tax and fee paid by real estate agents.

## REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: 12/15/2008

DEPARTMENT ID NUMBER: FN 08-007

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The City of Huntington Beach recognizes the real estate industry's relationship between a licensed real estate salesperson and a licensed real estate broker and will amend the code as follows:

### **5.08.020 Exemptions Generally**

(d) Real Estate Agents. Persons licensed by the California Department of Real Estate and having their license placed with a broker licensed by the Department of Real Estate for purposes of supervision and control, as required by state law, shall not be subject to taxation under this title if their broker pays the tax in accordance with the provisions of this title and includes the real estate agent as one of its employees for purposes of any computation of the tax.

The proposed ordinance language recommended by staff differs slightly from the language proposed by the attorney representing the Orange County Association of Realtors; Mr. Thomas Jacobson. A letter from Mr. Jacobson rebutting staff's ordinance language is attached (Attachment 6). The Alternative Action, not requiring brokers outside the City of Huntington Beach with agents operating in the City to obtain a business license, addresses the Orange County Association of Realtors request.

The amendment of the ordinance would be retroactive to January 1, 2006. Any currently licensed real estate salesperson with an active business license would receive notification that their business license has been closed effective on the date of ordinance adoption. The business license tax and fee paid in tax years 2006, 2007, and 2008, would be refunded for any licensed real estate agent with an active business license as of the ordinance adoption date. The business license refund would reduce the balance in the General Fund by approximately \$22,000, (\$19,000 in taxes and \$3,000 in fees).

### **Proposition 218**

Should the City Council approve the proposed amendment to the Municipal Code to add language exempting real estate agents, a future City wide Proposition 218 vote would be required to reinstate it back.

### **Strategic Plan Goal:**

Financial – Fully understand the financial implications of financial decision before they are made, and recognize and disclose fiscal impacts of the pension crisis.

### **Environmental Status:**

Not applicable

## REQUEST FOR CITY COUNCIL ACTION

MEETING DATE: 12/15/2008

DEPARTMENT ID NUMBER: FN 08-007

### Attachment(s):

City Clerk's Page Number	No.	Description
5	1.	Ordinance No. <u>3817</u> , "An Ordinance of the City of Huntington Beach Amending Chapter 5.08 of the Huntington Beach Municipal Code Relating to Business License Procedures."
13	2.	Franchise Tax Board-Business License Compliance Audit Memo to City Council Members dated October 24, 2006.
21	3.	Business License requirements Real Estate related business activity letters sent to real estate agents and brokers sent March 2008.
25	4.	Extension of the due date for full compliance with the city's municipal code letter sent to real estate agents and brokers dated April 1, 2008.
27	5.	Letters and correspondence on the position of Realtors as independent contractors but also employees of a real estate broker.
43	6.	Correspondence dated November 17, 2008, from Thomas N. Jacobson, Attorney at Law, representing of the Orange County Association of REALTORS.

# **ATTACHMENT #1**

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ORDINANCE NO. 3817

AN ORDINANCE OF THE CITY OF HUNTINGTON BEACH  
AMENDING CHAPTER 5.08 OF THE HUNTINGTON BEACH MUNICIPAL  
CODE RELATING TO LICENSING PROCEDURES

The City Council of the City of Huntington Beach does hereby ordain as follows:

SECTION 1. Section 5.08.020 of the Huntington Beach Municipal Code is hereby amended to add subsection (d), said subsection to read as follows:

(d) Real Estate Agents. Persons licensed by the California Department of Real Estate and having their license placed with a broker licensed by the California Department of Real Estate for purposes of supervision and control, as required by state law, shall not be subject to taxation under this title if their broker pays the tax in accordance with the provisions of this title and includes the real estate agent as one of its employees for purposes of any computation of the tax.

SECTION 2. This ordinance shall become effective 30 days after its adoption.

PASSED AND ADOPTED by the City Council of the City of Huntington Beach at a regular meeting thereof held on the \_\_\_\_\_ day of \_\_\_\_\_, 2008.

\_\_\_\_\_  
Mayor

ATTEST:

\_\_\_\_\_  
City Clerk

INITIATED AND APPROVED:

\_\_\_\_\_  
Finance Director

REVIEWED AND APPROVED:

\_\_\_\_\_  
City Administrator

APPROVED AS TO FORM:

\_\_\_\_\_  
City Attorney

7.23.08

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## LEGISLATIVE DRAFT

Ordinance No. 3817

### Section 5.08.020

5.08.020 Exemptions--Generally. Nothing in this title shall be deemed or construed to apply to any person transacting and carrying on any business exempt by virtue of the Constitution or applicable statutes of the United States or the State of California from payment of such taxes as are herein prescribed. (327-4/29, 766-7/60, 3603-6/03)

(a) Interstate commerce. None of the license taxes provided for by this title shall be so applied as to occasion an undue burden upon interstate commerce. In any case where a license tax is believed by a licensee or applicant for license to place an undue burden upon such commerce, he may apply to the Finance Director for an adjustment of the tax so that it shall not be discriminatory or unreasonable as to such commerce. Such application may be made before, at or within six (6) months after payment of the prescribed license tax. The applicant shall, by affidavit and supporting testimony, show his or her method of business and the average number of employees or estimated average number of employees and such other information as the Finance Director may deem necessary in order to determine the extent, if any, of such undue burden on such commerce. The Finance Director shall then conduct an investigation, and after having first obtained the written approval of the City Attorney, subject to the approval of the City Council, shall fix as the license tax for the applicant, an amount that is reasonable and nondiscriminatory, or if the license tax has already been paid, shall order a refund of the amount over and above the license tax so fixed. In fixing the license tax to be charged, the Finance Director shall have the power to base the license tax upon the average number of employees or any other measure which will assure that the license tax assessed shall be uniform with that assessed on businesses of like nature, so long as the amount assessed does not exceed the license tax as prescribed by this title. Should the Finance Director determine the average number of employees measure of license tax to be the proper basis, he or she may require the applicant to submit, either at the time of termination of applicant's business in the city or at the end of each three (3) month period, a sworn statement of the average number of employees and pay the amount of license tax therefor, provided that no additional license tax during any one (1) calendar year shall be required after the licensee shall have paid an amount equal to the annual license tax as prescribed in this title. (3603-6/03, 3751-11/06)

1. Any person claiming an exemption pursuant to this chapter shall file a verified statement with the Finance Director stating the facts upon which exemption is claimed. (3603-6/03, 3751-11/06)
2. The Finance Director shall, upon a proper showing contained in the verified statement, subject to approval of the City Council, issue a license to such person claiming exemption under this section without payment to the city of the license tax required by this title. (3603-6/03, 3751-11/06)
3. The Finance Director, after giving notice and a reasonable opportunity for hearing to a licensee, as provided in sections 5.08.240 and 5.08.250, may revoke any license granted pursuant to the provisions of this section upon information that the licensee is not entitled to the exemption as provided herein. (3603-6/03, 3751-11/06)

(b) Charitable and nonprofit organizations. As used in this title, “charitable” and “nonprofit organizations” shall include only religious, charitable, fraternal, educational, military, state, county or municipal organizations or associations as defined by *Internal Revenue Code* §501(c). The provisions of this chapter shall not be deemed or construed to require the payment of a license tax to conduct, manage or carry on any business, occupation or activity from any institution or organization which is conducted, managed or carried on wholly for the benefit of charitable purposes or from which profit is not derived, either directly or indirectly, by any, person, nor shall any license tax be required for the conducting of any entertainment, concert, exhibition or lecture on scientific, historical, literary, religious or moral subjects within the City whenever the receipts of any such entertainment, concert, exhibition or lecture are to be appropriated at any church or school or to any religious or benevolent purpose; nor shall any license tax be required for the conducting of any entertainment, dance, concert, exhibition or lecture by a religious, charitable, fraternal, educational, military, state, county, or municipal organizations or associations, or lecture are to be appropriated for the purpose and object for which such organization or association was formed and from which profit is not derived, either directly or indirectly, by any person, provided, however, that nothing in this section shall be deemed to exempt any such organization or association from complying with any of the provisions of this code requiring a permit from the City Council or other City department, or any commission or officer to conduct, manage or carry on any profession, trade calling or occupation. (3603-6/03)

(c) Disabled veterans—Exempted when. Every honorably discharged soldier, sailor or marine of the United States, who is physically unable to obtain his or her livelihood by means of manual labor and who is a qualified voter of the State of California, shall have the right to hawk, peddle and vend any goods, wares, or merchandise owned by him, except spiritous, malt, vinous or other intoxicating beverages, without the payment of a license fee, subject, however, to the restrictions, limitations, regulations and conditions hereinafter set forth. Every applicant must comply with the following requirements before a license may be issued under the provisions of this chapter: (3603-6/03)

1. Every applicant must furnish a certificate of physical disability executed by a qualified surgeon of the United States Navy, Army, Marines, Air Force or U. S. Public Health Service, a certificate of honorable discharge from the United States Navy, Army, Marines, Air Force or U. S. Coast Guard, and a written recommendation from the representatives of the local posts of the American Legion and/or the Veterans of Foreign Wars. (3603-6/03)
2. Every applicant must furnish two (2) identification photographs, one to be attached to the license issued to said applicant, and the other to be attached to the copy retained by the Finance Director. The applicant must also sign both copies of the license at the time of the issuance thereof. (3603-6/03, 3751-11/06)

3. License issuance conditions. A license when issued is subject to the following conditions: (3603-6/03)

- (a) It is nontransferable and for the exclusive use of the licensee named; (3603-6/03)
- (b) Applicant’s identification photograph must be attached to the license at all times, and failure to comply herewith is grounds for revocation of the license and for refusing its renewal or the issuance of a new license thereafter; (3603-6/03)

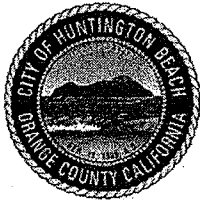
- (c) The licensee named must identify himself or herself by his or her signature and present a valid license whenever required to do so by a Police Officer or Finance Director; (3603-6/03, 3751-11/06)
- (d) Every license issued under the provisions of this section shall expire thirty (30) days from and after the date of issuance and a new license may thereafter be issued pursuant to the provisions of this section subject to review by the Finance Director; (3603-6/03, 3751-11/06)
- (e) It is unlawful for any person, other than the licensee named, to use or have in his or her possession any license issued pursuant to the provisions of this section; (3603-6/03)
- (f) It is unlawful for any person to purchase or transfer any license issued pursuant to the provisions of this section, or for any person to transfer or convey the certificates mentioned in Section 5.08.020(c)1 above, to any other person for the purpose of securing a license as herein provided. (3603-6/03)

(d) Real Estate Agents. Persons licensed by the California Department of Real Estate and having their license placed with a broker licensed by the California Department of Real Estate for purposes of supervision and control, as required by state law, shall not be subject to taxation under this title if their broker pays the tax in accordance with the provisions of this title and includes the real estate agent as one of its employees for purposes of any computation of the tax.

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# **ATTACHMENT #2**

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**CITY OF HUNTINGTON BEACH  
INTER-DEPARTMENTAL COMMUNICATION  
FINANCE OFFICE**

**TO:** Honorable Mayor and City Council Members

**FROM:** Jim Slobojan, Fiscal Services Manager - Finance

**DATE:** October 24, 2006

**SUBJECT:** FRANCHISE TAX BOARD-BUSINESS LICENSE COMPLIANCE AUDIT

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The City of Huntington Beach Municipal Code section 5.04.101 (f) defines "business" as professions, trades, and occupations and all and every kind of calling whether or not carried on for profit. It further identifies in H.B.M.C 5.08.010 that it is unlawful for any person to transact and carry on any business, trade, profession, calling or occupation in the city without first having procured a business license from the city. The business license section of the Finance Department utilizes various methods of discovery in its attempt to locate unlicensed businesses operating in the City. These methods include, but are not limited to, a review of State Board of Equalization data, Fire Inspection records, Fictitious Name filings and now the Franchise Tax Board (FTB).

The Local Government Sharing program with the Franchise Tax Board was developed out of the passage of Assembly Bill 63. This bill was passed in 2001 and created a new law, which requires the FTB to disclose certain information about taxpayers who reported income as trade or business. (Reference: Revenue & Taxation Code §19551.1). This program is designed to identify unlicensed businesses by capturing data from the Franchise Tax Board taxpayer database and comparing it against the city's business license database. The exceptions will be considered potential businesses operating in the city of Huntington Beach without a business license.

The Franchise Tax Board data file provided over 7,000 business entities that did not match the city's business license database. The large volume of data created requires us to show care in how we send notices to the potentially unlicensed businesses. We have chosen not to send all notices at once, as the responses would overwhelm our staff.

## Attachment 2

The Business License section of Finance will mail out a notice to specifically targeted entities that have listed Huntington Beach as their business address. It is possible for a business owner to use their home address in Huntington Beach for having their tax return mailed, but may actually be conducting business in another city. The business owner will have an opportunity to provide the city with details to their business location. If the business owner can show documentation that they are operating in a city other than Huntington Beach, they will then be removed from future notices. Any business entity receiving an FTB letter will have an opportunity to dispute the business license requirement first in writing and, if necessary, in a hearing with the business license staff. The schedule for each round of letters is as follows:

- Day 1: Mail out notices to predetermined businesses.
- Day 31: Mail out second notices to business that have not responded.\*
- Day 61: Review business that failed to respond and mail out Notice of Violation.\*\*
- Day 76: Issue Administrative Citation for non-compliance with Municipal Code.

\* A response may be categorized as a phone call, payment, returned mail or a filing for a business tax review.

\*\* A notice of violation carries no monetary penalty but does inform the issued of the Municipal Code violation.

The first phase will begin the first quarter of FY0607 and will target independent contractors, mainly those in the specialty trade (building and construction). The second phase will target the remaining Schedule C filers and other professional and technical services. The third phase will look at real estate agents while the fourth and final phase for FY0607 will capture all remaining legal entities (partnerships, LLC, Corporations).



Attachment 2

The following is a listing of local agencies that currently participate in the AB63 Local Government Sharing program with the Franchise Tax Board.

<u>CITY</u>	<u>AMOUNT COLLECTED TO DATE VIA FTB PROGRAM</u>
Hawthorne (pop. 88,790)	\$73,200
Los Angeles (pop. 3,957,875)	\$46 Million
Newport Beach (pop. 83,120)	\$1.8 Million (2003 - 2005)
San Francisco (pop. 799,263)	\$67,000 (Payroll tax/small bus exemption)
San Jose (pop. 944,857)	\$1.5 Million
Walnut Creek (pop. 66,501)	\$34,753
Carson (pop. 98,329)	Approximately a 20% increase in revenue
El Segundo (pop. 17,024)	Approximately \$75,000
Long Beach (pop. 491,564)	Revenue increase of approximately 3%

## **Franchise Tax Board Notices: Frequently Asked Questions (FAQs)**

**Q: What is the City's Franchise Tax Board business tax enforcement program?**

A: As a result of recent state legislation, the California State Franchise Tax Board (FTB) is now authorized to disclose certain records related to business activities of residents, corporations, and other entities within the City. By matching the data to our existing records we now have an additional, effective tool to identify unregistered businesses within the City.

**Q: Why did I receive a FTB notification?**

A: Our records from the FTB show that you are or the named entity is reporting some type of business activity to the FTB using a Huntington Beach address. This indicates you may be operating a business in the City that has not yet obtained a Business License Tax certificate.

**Q: I am not doing "business." What does the City of Huntington Beach consider to be a business and why do they think I am operating one?**

A: Most activities conducted within the City with continuing and regular basis are considered engaging in business and subject to business tax. Specifically, City Municipal Code defines business as: "Business" means professions, trades, and occupations and all and every kind of calling whether or not carried on for profit. (Municipal Code §5.04.010 (f)) State law (Business and Professions §16300) requires cities to use the way a taxpayer reported income to the IRS and Franchise Tax Board to determine whether the taxpayer performed services as an employee or as a separate business entity. A person who is an employee and whose compensation is reported on a Federal W-2 is not in business and is not subject to the business tax.

**Q: I do some minor consulting on a part-time basis. Do I have to get a Business License?**

A: Yes, businesses both large and small are required to obtain a Business License Tax Certificate to be in compliance with the Municipal Code. If the consulting work is performed as an independent contractor and attributable to a location within the City limits, such as your residence, a tax liability exists.

**Q: I receive a 1099 form instead of a W-2 from my work. Am I required to have a City of Huntington Beach Tax Certificate?**

A: Yes, those that work as an independent contractor and are paid by 1099 versus W-2 need to have a City of Huntington Beach Tax Certificate. State law (Business & Professions Code §16300) prohibits the imposition of business license tax on employees. In the case of a dispute between a taxpayer and the local agency, the local agency must defer to how the taxpayer reported income to the FTB.

**Q: My business entity (Corporation, LLC, Partnership, etc) is entirely passive and/or dormant and it is just paying a minimum tax to the Secretary of State. Is it required to get a license?**

A: Yes. If your business is registered active with the Secretary of State and reporting on a business return with the FTB and IRS, it will need a license. By maintaining a business entity within the City, whether it is transacting public business or not, is considered operating a business under the Municipal Code.

**Q: I live in Huntington Beach, but my business is located outside the city limits. What are my liabilities for the City of Huntington Beach?**

A: As long as all business activity is conducted outside the City of Huntington Beach, there is no need to obtain a City of Huntington Beach Business License. Please note the receipt of business mail at a PO Box in Huntington Beach is business in the City.

If you have additional questions please e-mail Business License at [jslobojan@surfcity-hb.org](mailto:jslobojan@surfcity-hb.org).

*Revenue & Taxation §19551.1*

19551.1. (a) The Franchise Tax Board may permit the tax officials of any city to obtain tax information pursuant to subdivision (a) of Section 19551.

(b) The information furnished to tax officials of a city under this section shall be limited as follows:

(1) When requested pursuant to a written agreement, the taxing authority of a city may be granted tax information only with respect to taxpayers with an address as reflected on the Franchise Tax Board's records within the jurisdictional boundaries of the city who report income from a trade or business to the Franchise Tax Board.

(2) The tax information that may be provided by the Franchise Tax Board to a city is limited to a taxpayer's name, address, social security or taxpayer identification number, and business activity code.

(3) Tax information provided to the taxing authority of a city may not be furnished to, or used by, any person other than an employee of that taxing authority.

(4) Section 19542 applies to this section.

(5) Section 19542.1 applies to this section.

(c) The Franchise Tax Board may not provide any information pursuant to this section until all of the following have occurred:

(1) An agreement has been executed between a city and the Franchise Tax Board, that provides that an amount equal to all first year costs necessary to furnish the city information pursuant to this section shall be received by the Franchise Tax Board before the Franchise Tax Board incurs any costs associated with the activity permitted by this section. For purposes of this section, first year costs include costs associated with, but not limited to, the purchasing of equipment, the development of processes, and labor.

(2) An agreement has been executed between a city and the Franchise Tax Board that provides that the annual costs incurred by the Franchise Tax Board, as a result of the activity permitted by this section, shall be reimbursed by the city to the board.

(3) Pursuant to the agreement described in paragraph (1), the Franchise Tax Board has received an amount equal to the first year costs.

(d) This section does not invalidate any other law. This section does not preclude any city or, city and county, from obtaining information about individual taxpayers, including those taxpayers exempt from this section, by any other means permitted by state or federal law.

(e) This section shall remain in effect only until December 31, 2008, and as of that date, is repealed.

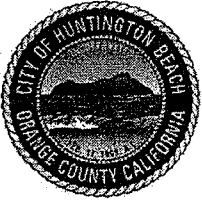
Via email to:

Dan T. Villella, Finance Director

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# **ATTACHMENT #3**

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# CITY OF HUNTINGTON BEACH

Business License Division – Finance

PO BOX 190

Huntington Beach, CA 92648-0190

«CURRENT\_DATE»

«FIRST\_NAME» «LAST\_NAME»  
«FIRST\_NAME\_2» «LAST\_NAME\_2»  
«ZP4\_ADDRESS»  
HUNTINGTON BEACH, CA «ZP4\_ZIP»

**Re: Business License requirement Real Estate related business activity.**

Dear Business Owner:

A review of your 2006 tax filing with the Franchise Tax Board (FTB) indicates you or a spouse reported business expenses or received income from business activity. The State of California Department of Real Estate data shows that you are working as a broker based in the City of Huntington Beach. All Independent Contractors conducting business activity in the City of Huntington Beach are required to obtain a City Business License. A search of our records did not reveal a valid business license for the above listed name(s) or address. Therefore you may be out of compliance with H.B.M.C. Section 5.08.010, which states:

**It shall be unlawful for any person to transact and carry on any business, trade, profession, calling or occupation in the city without first having procured a license from the city so to do or without complying with any and all provisions of this title.**

**Your business license tax has been calculated based on your 2006 tax filing with the Franchise Tax Board:**

Business License tax due for tax year 2006:	\$«AMOUNT_DUE_2006»
Business License tax due for tax year 2007:	\$«AMOUNT_DUE_2007»
Business License tax due for tax year 2008:	\$«AMOUNT_DUE_2008»
Processing fee	\$«FEE»
<b>TOTAL AMOUNT DUE BY «DUE_DATE»:</b>	<b>\$«TOTAL_TAX_DUE»</b>

Please complete the enclosed application and return it in the enclosed envelope prior to «DUE\_DATE» with a check in the amount of \$«TOTAL\_TAX\_DUE» made payable to the City of Huntington Beach. **Failure to respond to this notice will result in further enforcement action and penalties.**

If you have licensed your business with the City of Huntington Beach, please return this letter indicating your business name and current business license number below. If you have any questions, please contact a Business License representative at (714) 536-5267 or visit the city website at:

**[http://www.surfcity-hb.org/Business/license\\_permit\\_codes/business\\_license.cfm](http://www.surfcity-hb.org/Business/license_permit_codes/business_license.cfm)**

Business Name \_\_\_\_\_

Business License Number \_\_\_\_\_

Enclosure(s)

Ref: FTB-RE-AGT-1



# **CITY OF HUNTINGTON BEACH**

## **Business License Division – Finance**

### ***Franchise Tax Board Notices: Frequently Asked Questions (FAQs)***

**Q: Why did I receive a Franchise Tax Board (FTB) notification?**

A: Our records from the FTB show that you are or the named entity is reporting some type of business activity to the FTB using a Huntington Beach address. This indicates you may be operating a business in the City that has not yet obtained a Business License. The City of Huntington Beach Business License Office is currently auditing everyone who has filed a Schedule C using a Principal Business Activity code (PBA) that relates to Real Estate showing a Huntington Beach address.

**Q: I haven't sold a house or property in a while, do I still need to obtain a Business License?**

A: Yes. Even though you may not have a current listing or haven't recently sold a house or property, that doesn't mean you're not conducting business. The fact that you hold an active license with the Department of Real Estate states that you are able to contract at any time. If a potential buyer or seller called you today and asked if you could offer them your Real Estate services and your answer is yes, then you are open for business. The City Municipal Code defines business as: ...professions, trades, and occupations and all and every kind of calling whether or not carried on for profit. (Municipal Code §5.04.010 (f))

**Q: The Broker I work under already has a City Business License, don't I work under his?**

A: No. If your broker / salesperson arrangement is set up such that you receive a Form 1099 from him, then you are considered to be an Independent Contractor. State law (Business and Professions §16300) requires cities to use the way a taxpayer reported income to the IRS and Franchise Tax Board to determine whether the taxpayer performed services as an employee or as a separate business entity. A person who receives a Form 1099 for their income is considered to be an Independent Contractor and their own business entity, therefore needing their own business license.

**Q: I receive a 1099 form instead of a W-2 from my work. Am I required to have Business License?**

A: Yes, those that work as an independent contractor and are paid by 1099 versus W-2 are required to have a business license in Huntington Beach. State law (Business & Professions Code §16300) prohibits the imposition of business license tax on employees. In the case of a dispute between a taxpayer and the local agency, the local agency must defer to how the taxpayer reported income to the FTB.

State law (Business and Professions §16300) requires cities to use the way a taxpayer reported income to the IRS and Franchise Tax Board to determine whether the taxpayer performed services as an employee or as a separate business entity. A person who is an employee and whose compensation is reported on a Federal W-2 is not in business and is not subject to the business tax.

**Q: I live in Huntington Beach, but my business is located outside the city limits. What are my liabilities for the City of Huntington Beach?**

A: As long as all business activity is conducted outside the City of Huntington Beach, there is no need to obtain a City of Huntington Beach Business License. Please note the receipt of business mail at a PO Box in Huntington Beach is business in the City.

**If you have additional questions please e-mail Business License at [jslobojan@surfcity-hb.org](mailto:jslobojan@surfcity-hb.org).**



# **ATTACHMENT #4**



# CITY OF HUNTINGTON BEACH

Business License Division – Finance

PO BOX 190

Huntington Beach, CA 92648-0190

April 1, 2008

«FIRST\_NAME» «LAST\_NAME»  
«FIRST\_NAME\_2» «LAST\_NAME\_2»  
«ZP4\_ADDRESS»  
HUNTINGTON BEACH, CA «ZP4\_ZIP»

The City of Huntington Beach Fiscal Services Division recently sent a tax due notification letter to select real estate sales agents conducting business in the city without a business license. The real estate sales agents were selected through a data sharing program with the State of California Franchise Tax Board.

A sales agent received the letter based on their filing of a Schedule C with their State tax return. Assembly Bill 205 provides that the manner in which a taxpayer reports or reported income to the Franchise Tax Board (FTB) or the Internal Revenue Service (IRS) shall create a presumption for local tax officials about whether a taxpayer is an employee or operated a business. In other words, if the real estate sales agent states to the IRS or FTB that they are a business (by filing a Schedule C) then they cannot claim to the City of Huntington Beach that they are an employee.

Due to certain concerns raised by the Orange County Association of Realtors, we are extending the due date for full compliance with the city's municipal code. The letter currently states a business license tax payment due date of April 10, 2008. The updated due date is June 9, 2008.

If you already submitted your payment, we thank you for your prompt response and compliance with the City's municipal code.

The City of Huntington Beach Business License section is available to answer any questions that a sales agent may have regarding the requirements of the letter. They may be reached at 714-536-5267.

Sincerely,

Jim Slobojan  
Fiscal Services Manager - City of Huntington Beach Finance Department

cc: Paul Emery, City of Huntington Beach  
Bob Hall, City of Huntington Beach  
Dan Vilella, City of Huntington Beach  
Thomas N. Jacobson, Attorney at Law  
Dave Stefanides, Orange County Association of Realtors  
Mary Jane Cambria, Orange County Association of Realtors  
Phil Hawkins, Pacific West Association of Realtors  
Ryan Smith, Pacific West Association of Realtors  
Teri Miles, Star Real Estate

# **ATTACHMENT #5**

**INTENTIONALLY  
LEFT  
BLANK**



*1 Step Ahead*

April 1, 2008

Paul Emery  
Interim City Administrator  
City of Huntington Beach  
2000 Main Street  
Huntington Beach, CA 92648

Dear Mr. Emery:

Thank you for making your staff available to meet with us to discuss the application of the business license tax to real estate professionals. We trust the dialogue which began today will eventually result in a fair and equitable application of the tax.

As we discussed during our meeting, there are several factors that distinguish the activities of a real estate salesperson from other trades and businesses transacting business in Huntington Beach.

Real estate salespersons are licensed by the California Department of Real Estate and are required to work for a licensed real estate broker. Salespersons cannot act on their own and cannot earn compensation based on their position as a licensed salesperson. Remuneration for assisting buyers and sellers in the sale of real property is paid to a broker and the broker shares with the salesperson a portion of the commission based upon the agreement between the salesperson and the broker. The broker is wholly responsible for maintaining the records of these transactions, including, but not limited to, all of the written documentation of the transaction, the trust account activity, the files, and other aspects of each and every transaction run through the broker's office. Almost all of the activity relating to a real estate transaction is performed in the broker's office, including the processing of offers, loan-related material, title matters, and multiple-listing (MLS) input.

A real estate agent may take a listing to sell property located in numerous jurisdictions, however, the work related to assisting sellers and buyers in the sale and purchase of property is accomplished in the broker's office using the tools of the trade controlled by the broker.

We do not disagree that a real estate broker having an office in Huntington Beach and employing several agents should be liable for the business license tax based

Laguna Hills Office:  
25552 La Paz Road  
Laguna Hills, CA 92653  
949-586-6800  
fax 949-586-0382  
www.ocar.org

Huntington Beach Office:  
8071 Slater Avenue, Ste. 240  
Huntington Beach, CA 92647  
714-375-9313  
fax 714-375-9322  
www.ocar.org

Letter to Mr. Paul Emery  
April 1, 2008  
Page Two

upon the number of employees and salespersons affiliated with that office. We also believe that this is the responsibility of other municipalities where brokers and salespersons are officed, the broker should pay that jurisdiction's business license tax based upon the rules applicable in that community. We do believe it is unfair and inequitable to require a salesperson to obtain a business license tax for assisting a buyer or a seller with property in Huntington Beach solely on the basis of being a salesperson ushering the parties through the Huntington Beach transaction.

We also discussed in our meeting, that although a salesperson may be compensated with the payment of a commission, rather than through wages, the salesperson is still acting on behalf of the broker and with the limitations of imposed rules established by the Department of Real Estate. By way of example, a salesperson must always obtain the approval and review of a broker when submitting offers or preparing any of the documents required to complete a real estate transaction. The broker is the only party that may authorize changes to the multiple-listing service with regard to listing information. If the agent leaves the employment of the broker, the listing remains with the broker and the only manner in which the listing may follow the agent is for the homeowner to enter into an agreement with the broker, allowing for the transfer of the listing from one broker to another broker.

We also noted that salespersons are subject to other requirements of employees, such as the requirement to be covered by workers' compensation. Despite the fact that agents may be classified as independent contractors for purpose of taxation, this has only been done because of the unique nature of representing buyers and sellers in real estate transactions. They do not possess any other characteristics of an independent business and the business license tax can be imposed upon the broker at the broker's office location. We believe the current system employed by Huntington Beach establishes an inequitable and unfair method of taxing certain professionals while not imposing the tax on professionals in other locations that have the same characteristics.

We look forward to continuing our dialogue.

Sincerely,

A handwritten signature in dark ink, appearing to read 'D. Stefanides', with a stylized flourish at the end.

Dave Stefanides  
Government Affairs Director

cc: Mr. Bob Hall, Mr. Dan Villella, Mr. Jim Slobojan

**THOMAS N. JACOBSON**  
ATTORNEY AT LAW

3750 SANTA FE, SUITE 105  
RIVERSIDE, CALIFORNIA 92507  
(951) 682-7882 • FACSIMILE (951) 682-7884  
tom@tomjacobsonlaw.com

REC-1  
JUL 10 2008

July 7, 2008

The Honorable Debbie Cook and Members of the Council  
City of Huntington Beach  
200 Main Street  
Huntington Beach, CA 92648

Re: Huntington Beach Municipal Code, Sections 5.08.010 et. seq., Business License  
Tax assessed against Real Estate Salespersons and Brokers not acting in the  
capacity as the Broker of Record

Dear Mayor Cook and Members of the Council:

I represent the Orange County Association of REALTORS®, the trade association representing over 10,000 real estate professionals in Orange County, including Huntington Beach. We have been having discussions with the City concerning the imposition of the Business License Tax on real estate licensees who are not acting in the capacity of the office broker and submit that the Business License Tax should not be imposed upon such individuals because it discriminates against a particular class of employee. We support the City's efforts to collect Business License Taxes from brokers employing salespersons and employing brokers working in the capacity as salespersons (both categories of which will be hereafter referred to sometimes as "agents"), and submit this is the fair and non-discriminatory manner to address responsibility for the Business License Tax.

Currently, the City of Huntington Beach is proposing to levy the Business License Tax upon every licensee having an address in Huntington Beach. Staff has determined the tax should be levied upon every licensee who reported to the State Franchise Tax Board an address in Huntington Beach and filed a Schedule C with their personal tax return. The basis for the Staff's determination is that Schedule C is traditionally filed in California by independent contractors and is not generally a form used by employees to report income for income tax purposes.

We acknowledge that for many purposes a distinction between an employee and an independent contractor can be ascertained by examining whether the individual filed a Schedule C with the State Franchise Tax Board. Like most generalizations, there are always exceptions, and not everything will fit into the category made by the generalization. This is one of those cases.

Thomas N. Jacobson

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An examination as to why real estate professionals file Schedule C is helpful to understand how this issue arose. Many years ago the real estate industry and the IRS reached an understanding that because of the unpredictability and irregularity of receipt of income by real estate professionals, and the irregularity of the business expenses incurred by real estate professionals, it was in the best interest of the taxing authorities and the individuals if real estate professionals reported income as though they were independent contractors. In general, the problem faced by the real estate professional and such entities as the IRS were that if a real estate professional received a large commission, and it were treated as ordinary income, it would be annualized and possibly too much tax would be withheld. On the other hand, in those periods when a real estate professional received a lesser amount of commission, the amount of withholding would be too little. To best address the irregularity of income and expenses, the real estate industry and IRS agreed to have real estate professionals report income as independent contractors, even though, as addressed below, none of the other attributes of an independent contractor are present in the relationship between the agent and the broker.

As the Council is well aware, real estate professionals are issued licenses by the California Department of Real Estate. There are two categories of licenses: (1) Broker's License, and (2) Salesperson's License. One of the concepts of the license is that a Salesperson must always work under the direct supervision and control of a Broker and cannot operate a business independent of the Broker. The commonly used phrase to describe the broker responsible for all of the activities of a particular business, and for supervision of all of the agents in the office (irrespective as to whether they hold a Salesperson's license or a Broker's license) is the "Broker of Record".

As mentioned to above, one of the areas of confusion that arises from time to time involves those individuals who obtain a Broker's license, but for reasons that are personal to them, elect to join a firm and work for the Broker of Record. Though in possession of a Broker's license they perform the same services as a Salesperson and subject themselves to the same rules of supervision as a Salesperson. For all practical purposes they are equivalent to the Salesperson, especially in the requirement of supervision and their relationship to the Broker of Record.

A Salesperson and a Broker not acting in the capacity as a Broker of Record cannot be true independent contractors for several reasons:

1. The Department of Real Estate requires that licensees affiliated with a particular broker must be fully supervised in all activities relating to their activities in the real estate industry. An agent cannot contract in their own name and can only be employed by a licensed real estate broker. *California Business and Professions Code*, Section 10132.



Thomas N. Jacobson

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2. The listings that are taken by the agent belong to the Broker of Record. Absent a specific agreement to the contrary, those listings cannot be taken by the agent if they leave the firm and place their license with another Broker of Record. The listings belong to the original broker.
3. All of the acts of the agent must be approved and authorized by the Broker of Record. All advertising and marketing must be approved by the Broker of Record, and as is the case of any employer, the Broker of Record is responsible for all of the acts and omissions of the agent.
4. Workers' Compensation insurance is carried by the Broker of Record based on the number of agents working for the Broker of Record.
5. The commissions payable on a transaction are paid to the Broker of Record, even if disbursed through escrow, and the split payable to the agent is a matter of agreement and payable by the Broker of Record to the agent when the commission is paid to the Broker of Record. *Gipson v. Davis Realty Company*, 215 Cal. App. 2<sup>nd</sup> 190, 203 (1963) The State of California has taken the position that it can take jurisdiction over a commission dispute between a Broker of Record and an agent in the same manner as any employee complaining about compensation issues. If the agent were a true independent contractor the State would not have jurisdiction and it would be a pure civil matter, such as when a homeowner has a dispute with a home improvement contractor. *Resnik v. Anderson and Miles*, 109 Cal App. 3<sup>rd</sup> 569, 572-573 (1980)
6. There is no scenario under which an agent (except an agent holding a broker's license if they elect to open their own business) can function as an independent business. A salesperson must always have their license "hung" with a broker in order to transact the business contemplated by their license. The legislature of this state recognizes the salesperson as an employee of the broker "as a matter of law". *Resnik v. Anderson and Miles*, 109 Cal. App. 3d 569, 572 (1980).
7. Errors and Omissions Insurance is carried through the Broker of Record. Carriers do not write E&O insurance for individual agents because the broker must be covered for each transaction in which an agent is involved.
8. Agents cannot work for two Brokers of record at the same time. *California Business and Professions Code*, Section 10137
9. The California courts have held the Broker of Record is responsible for all of the acts and omissions of the licensee. *Grubb & Ellis Co. v. Spengler*, 143 Cal. App. 3d 890, 895 (1983).

Thomas N. Jacobson

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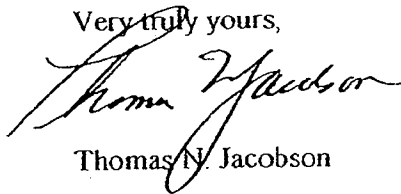
10. Courts have held the agent is an agent of the Broker of Record but may not be an independent contractor. As noted in *Payne v. White House Properties*, 112 Cal. App. 3d 465, 471 (1980): "*The conclusion is that a real estate salesperson may not be an independent contractor, and is an agent as a matter of law.*"

My client does not oppose the proper application of the Business License Tax. My client believes that Brokers of Record and their office should be the focus of the Business License Tax. By focusing the tax on the office, the City will be consistently enforcing the tax and the incidence of taxation. The City does not currently tax, nor propose to tax, employees of businesses just because the employee has an address in the City of Huntington Beach. It should not make an exception for real estate professionals and tax their activities at any other situs than the office from which business is transacted and at which the Broker of Record resides.

Our discussions with the City have noted the difference between a real estate professional and the home improvement contractor that enters the City to undertake a remodeling job. The contractor is the "boss" of his or her business. They make all of the decisions and their license from the State of California allows them to act without the supervision of another individual. Such is not the case with the real estate agent. The real estate agent has an umbilical cord attached to its Broker of Record. No other profession operating in Huntington Beach has that umbilical cord and the ten factors listed above.

We have taken the liberty to prepare a proposed clarification to the ordinance. The proposed clarification is attached to this letter. We are available to meet concerning the proposed clarification and welcome any questions or suggestion the Council or Staff may have concerning this matter.

Very truly yours,



Thomas N. Jacobson

From:

07/10/2008 16:39 #062 P.002/002

(d) Real Estate Licensees. A person licensed by the California Department of Real Estate (Licensee) and having their license placed with a broker licensed by the California Department of Real Estate for purposes of supervision and control shall not be subject to taxation under this title. In the event the broker of the Licensee operates a business office or office location within the jurisdiction of the City, in order for the licensee to be exempt from taxation pursuant to this title, their broker must pay the tax in accordance with the provisions of this title and include the Licensee as one its employees for purposes of any computation of the tax.

## The Government Report

The City of Huntington Beach Business License Department contacted more than 300 REALTORS® by letter recently, claiming they owe \$248 in business license taxes for the years 2006, 2007, and 2008.

Several agents who received the notice contacted me at the Orange County Association of REALTORS® to ask why the City of Huntington Beach was suddenly attempting to collect business license taxes from them.

We arranged for a meeting with the City's Fiscal Services Department to find out more and to request an extension of the deadline agents had been given which was, at the time, April 10th. We were granted a payment extension until June 9, 2008. Here is what we found out in our meeting in April.

The Fiscal Services staff in Huntington Beach possesses individual tax information given them by the Franchise Tax Board (FTB) courtesy of the State Legislature which passed a bill authorizing the sharing of taxpayer information with local governments.

The City uses the tax data to identify REALTORS® using a Huntington Beach address to file a Schedule C with their California State tax returns. Agents are not pursued by the City if their name does not also appear with the records of the Department of Real Estate as having their license with a broker having an office in Huntington Beach.

The City Fiscal Services staff believes that Assembly Bill 205 allows cities to presume that the manner in which a taxpayer reports income to the FTB or to the Internal Revenue Service determines whether an individual is an employee or operator of a business.

Under Huntington Beach Municipal Code Section 5.08.010, it is unlawful for any person to carry on a business, trade, profession, or occupation in the city without first having procured a license from the city and paid a license tax. At some point, the City staff determined it would require REALTORS® and non-REALTOR® real estate agents to pay the tax solely on the basis that the individual filed a Schedule C.

Your Association strongly disagrees and we are working diligently to clarify that real estate agents are not independent contractors for the purpose of interpreting the obligations imposed by the tax ordinance. Though the relationship between a salesperson and broker is unlike a supervisor and his or her office workers, it retains all of the characteristics that exist between an employer and employee.

California law clarifies that a real estate agent is a person employed by a licensed real estate broker (Business & Professions Code Section 10132). It further protects employees by prohibiting cities from requiring them to obtain a business license (B&P Sec. 16300). Additionally, state law prohibits real estate agents from being employed or compensated by anyone other than the broker for whom he or she works. (B&P Sec. 10137). Finally, state law declares that the agent's license shall remain in the possession of a licensed broker until the agent leaves the employ of the broker. (B&P Sec. 10160).

*"Under Huntington Beach Municipal Code Section 5.08.010, it is unlawful for any person to carry on a business, trade, profession, or occupation in the city without first having procured a license from the city and paid a license tax."*

The courts, too, provide justification to classify our real estate agents as employees. In deciding whether a worker is an independent contractor or an employee, the courts look at the facts related to three things: behavioral control, financial control, and relationship of the parties.

Generally, the broker controls most of what a salesperson does and often provides training to teach their practices and procedures. The broker is wholly responsible for generating and maintaining the records of a transaction, the trust account activity, the files, and other aspects of each and every transaction run through the broker's office. Almost all of the activity relating to a real estate transaction is performed in the broker's office, including the processing of offers, loan-related material, title matters, and the multiple-listing input.

A real estate agent may take a listing to sell property located in numerous towns; however, the work related to assisting sellers and buyers in the sale and purchase of property is accomplished in the broker's office using the tools of the trade controlled by the broker. The seller has given no instructions to and has not imposed any duty on the broker to pay any portion of the commission to the salesperson.

The discussion in Huntington Beach is important because it allows us to correct a misunderstanding about what REALTORS® do and how they operate. It shows REALTORS® do not act alone, but in concert with their entire Broker Office Team to assist clients when buying and selling a home in Huntington Beach. Your Association is actively committed to informing the community and government about the manner in which we help residents purchase and sell the American dream.

## Realtors!

**Sell more homes with the help of Jon Margolis, your FHA Expert**

LTV	Documentation	1 <sup>st</sup> Loan	Sales Price
97%	Full Doc	\$729,750	\$752,320

### FHA loan limits by county:

Orange & Los Angeles:	\$729,750
San Diego:	\$697,500
Riverside / San Bernardino:	\$500,000

### How can FHA approve more buyers?

- > No Minimum Credit Score
- > Non Traditional Credit OK
- > Low Down Payment
- > Non-Occupant Co-Borrowers OK
- > No prepayment Penalties
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**Jon Margolis**

Sales Manager

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Aliso Viejo, CA 92656

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714-606-3009 Mobile

jon\_margolis@countrywide.com

www.lendingpool.com



## Independent Broker Forum

At IBF's recent forum, Stella Ling, C.A.R. Senior Counsel, discussed "Handling REO Transactions." She presented solutions to common problems REALTORS® face during these types of transactions. Kevin Budde with Countrywide Home Loans provided a "Mortgage Lending Update," including current information regarding the guidelines for conforming and FHA loans issues. IBF member, Frank Hill, stated "These meetings assist the smaller offices and brokerages to meet and exchange ideas, discuss concerns and get to know each other."



President Don Readinger, Stella Ling, Kevin Budde and IBF Chair Paula Cosenza

Our next IBF meeting is scheduled for Tuesday, May 27th. Joshua Sharfman, Chief Technical Officer with the California Association of REALTORS® will be the guest speaker. All meetings are held at the OCAR Laguna Hills office, 25552 La Paz Road. For more information, please call (949) 586-6800.



Home Page > Meetings & Events > C.A.R. Business Meetings > Committee Materials Archive > January 2006 Committees > Local Governmental Relations > Local E  
License

## Local Business License Taxes

find the article at: "<http://www.car.org/meetings/carmmeetings/committee-materials-archive/83191/83761/88453/>"

Local Business License Taxes December 20, 2005 Legislative Committee

Local Government Relations Committee

Taxation Committee *This Issues Briefing Paper is for discussion purposes only and has not been approved by the Legislative, Local Governmental Relations, Taxation or Executive Committees or the Board of Directors.* Issue:

Should C.A.R. sponsor legislation regarding the collection of business license taxes by local jurisdictions? Action:

Optional Options:

1. Do Nothing. Existing policy; requires Realtors to fight inappropriate taxes at the local level, does not change cities' authority to tax or the licensees' independent contractor status.
2. "Have our cake and eat it too" - Change the characterization of real estate salespersons and broker associates to that of "employee" for BLT (Business License Tax) purposes, while at the same time preserving the status of "independent contractor" for all other purposes.
3. Business Entity taxation - Prohibit the application of a BLT to a regulated business entity except at the office address(es) shown in the regulatory records of the business.
4. Other Status/ Summary:

Cities have become increasingly aggressive and creative in applying business license taxes to real estate license activities, and every indication is that the pressure on municipal revenues will increase. The law is clear that municipalities can tax business activities within their jurisdiction, but the power is limited to a tax apportioned to the level of activity actually performed in the jurisdiction. Cities have begun to apply tax ordinances to real estate sales more broadly than before, have begun to treat each independent contractor salesperson as a separate business (thus owing a separate tax) and have begun to utilize aggressive contract collection companies to pursue real estate licensees. C.A.R. has twice appointed special task forces to study the situation (most recently in 2004) and twice concluded that the best strategy to address the situation is strong advocacy efforts by Realtors at the local level. In particular, the Task Forces have rejected strategies that include any concession that real estate salespersons might be "employees" for any purpose, including for BLT calculations.

Discussion:

All cities have as part of their inherent "police" powers the authority to raise revenue by taxing the privilege of doing business within the jurisdiction. Over the years the courts have affirmed that power, so long as the tax levied is properly apportioned to the amount of business activity actually carried out in the jurisdiction. For this reason, a flat fee BLT is inconsistent with the law – but often not challenged by Realtors® and other businesses because the flat fee is so nominal that any apportioned fee is bound to end up being more expensive and more difficult to comply with. In order to comply with the law, more progressive cities have sought to assess a tax based upon a business' gross receipts generated within

the jurisdiction. Note that simply assessing a multi-jurisdictional business based on its gross receipts is just as legally flawed as imposing a flat fee, unless the gross receipts are those earned *within the jurisdiction*. Unfortunately for cities, any apportionment of activity in a service oriented business like real estate is necessarily arbitrary and hard to validate. The Problems

- Multiple Jurisdictions. If a real estate licensee practices across multiple city boundaries, an inappropriately apportioned tax will tax the same income in multiple places and effectively force the licensee to pay a much higher tax rate. In some urbanized areas a single licensee may practice in (or just pass through) as many as a dozen different jurisdictions, all of which would like to collect a tax. - "Double" Taxation of Salesperson Commissions. If a city concludes that an independent contractor is a business separate from an employing or supervising broker, it is encouraged to tax the commission proceeds flowing to the salesperson from the employing broker. If the city does so, these proceeds will have already been included in the gross receipts attributed to the employing broker prior to the pass-through of the commission split.

- Heavy-Handed Enforcement. Some cities have attempted to creatively apply existing BLT ordinances to previously untaxed sales activities, and have even sought back taxes and penalties from licensees from whom they never before attempted to collect. The problem has also been worsened by contract (commission based) collection companies that aggressively interpret existing ordinances and apply them as broadly as possible. See "Municipal Auditing Companies," prepared for January 2006, and September 2005 Taxation Committee for additional information. The only options to change the result in business license rules are to use political power to defeat the tax ordinances at the local level; change the status of real estate practitioners so that they become members of a non-taxable category; or go to state law and change the way the tax itself is applied. Possible Solutions Both of the recent task forces on BLT have been unequivocal on their recommendation to the Board of Directors. They have recommended against any response that might put at risk the continued ability to characterize sales agents as independent contractors. That status carries significant advantages for agents in the form of tax deductions (auto, home office, no withholding) and for employing brokers (administrative savings, reduced liability, avoiding FICA/Social Security match). While some administrative decisions have gone against C.A.R. (most notably the assertion by the state that workers compensation must be purchased covering sales agents) C.A.R. has continued to maintain that agents can be employed as independent contractors if they choose that status. A Political Reality Check. California cities are already disenchanted (to put it mildly) with C.A.R.'s legislation restricting local control over the construction of affordable housing. They were even successful in requesting a veto of one of C.A.R.'s bills last year. If cities believe that their ability to raise revenues and their ability to control local business activity is under attack, they can be expected to strongly oppose the legislation. Potential Solutions for the Problem of Taxation in Multiple Jurisdictions. In some urbanized areas a single agent may have a home office in one city, an employing broker in another city, and list and sell properties in as many as ten or more surrounding cities. Each city may attempt to charge a business license tax for the privilege of doing business within its boundaries. While one might argue (and city representatives certainly do) that a business license fee is a small price to pay for being able to sell half-million dollar properties, the agent may soon feel that he or she is being "nickel and dimed to death." Employee vs. Independent Contractor. Because BLTs typically apply to businesses, and not to each employee of a business, one solution might be to restructure the relationship between salespersons and employing brokers so that salespeople are clearly

employees. Some real estate companies use an employee model. As noted above, this approach has so many negative consequences that most companies find it unacceptable. Cake Saving Rules. A variation of the employee approach is attempting to "have our cake and eat it too" - that is, characterizing real estate salespersons and broker associates as "employees" for BLT purposes, while at the same time preserving the status of "independent contractor" for all other purposes. Some Associations of Realtors® have had some success at the local level by arguing that the unique relationship between brokers and agents is more like that of employees and ought to be treated as such. Unfortunately, such a conclusion is not legally required and is unlikely to be successful without a strong public relations and governmental relations effort. Even worse, it is less likely to be successful in situations where the city has already put a business license tax in place. If a contractual change to employee is unacceptable, and persuading the city to treat agents that way is unsuccessful, a final option might be statewide legislation attempting to define agents as employees ONLY for the purposes of BLT. C.A.R. task forces have twice (in 1998 and 2004) rejected this approach. They reasoned that C.A.R. has always maintained that agents are independent contractors, and not conceded that they are employees for any purpose. They were also concerned that opening the door to treatment as employees for one purpose would make it politically difficult to resist the efforts of others to make them employees for all purposes. Indeed, yielding on employment status for the business license might actually encourage efforts to re-classify agents.

NOTE: agents have been characterized as employees for the purposes of workers compensation, but it is a status that was forced upon them and not chosen. However, since workers compensation confers significant liability protections on employers, Realtors have not resisted the mandate as much as they might have.

Business Location - Taxing the Business and Not the Workers. If we are unable to resolve problems by changes in the broker-agent relationship, another approach might be to change the business license tax itself. One approach might be to change the law so that a city could only tax a state regulated business activity (e.g. real estate) only at the location(s) where the state regulator's records show the business to be located. In this approach each city would be able to assess all the real estate companies that "hang" a license within the city, but not those whose regulatory address is outside the jurisdiction - even if they sell properties within the city. Taxing only offices within a city would deprive the city of jurisdiction over agents from outside the city boundaries when they sell there, but would also give the city the ability to tax all of a local office's business activity even if generated outside the city boundaries. Potential Solutions for "Double" Taxation of Commissions. The issue of double taxation is also related to sales agents' independent contractor status. When a listing broker receives payment of a commission out of escrow the broker triggers a tax assessment based upon that business activity. If the tax is measured by the gross receipts of business, the broker is being taxed upon both the broker's share and the listing agent's shares of the commission. However, when the broker pays the agent's share of the commission (either directly or through escrow) to an independent contractor, some cities assert that the compensation is to an independent business and subject to a business license tax. They take this position even though the same dollars were taxed as part of the broker's gross receipts as they were passed through to the sales agent. Employees Only. Typically, a business license tax is applied to a business and not its employees, so if an agent were to be an employee, rather than an independent contractor, the issue would be moot. It does not appear that any real estate companies have been willing to trade independent

contractor status for employee status as a way to reduce a local business license tax. Saving our Cake City by City. It is possible for a local ordinance to be structured in such a way as to treat salespeople as employees regardless of their employment relationship with their broker. Los Angeles reportedly has such an approach. In theory, since local taxation ordinances are the product of local political action, an appropriate political campaign can achieve a Realtor-friendly result. Such would be a "cake and eat it too" approach on a jurisdiction by jurisdiction basis. In practice, such special treatment in the tax ordinance will reduce the revenue to the city, and only an extraordinary effort by local Realtors is likely to succeed. Unfortunately, there has been mixed success at the local level.

**Business Location - Taxes at the Home Address.**

A business location limitation does not lend itself to a local approach, because state law only allows a city to tax the business on an apportioned basis—that is, on the amount of business activity generated in the jurisdiction. Since it can not tax out of area activity, businesses could "game" the system and avoid owing any tax at all—cities would never enact such a rule. However, if state law is changed to allow cities to attribute all of a business's activity to its "legal" location, the wide distribution of businesses will create a rough equity of distribution of tax proceeds among the jurisdictions. What cities lose in being unable to tax out of area businesses, they can make up in applying their tax to all of local business's revenue, even if the business takes place out of the area.

**SHOULD C.A.R. SPONSOR LEGISLATION TO CHANGE THE BUSINESS LICENSE TAX LAW?** If C.A.R. attempts to change the Business License Tax law, which of the available options should it pursue?



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## Business License Tax

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Cities have become increasingly aggressive and creative in applying business license taxes to real estate license activities, and every indication is that the pressure on municipal revenues will increase.

The law is clear that municipalities can tax business activities within their jurisdiction, but the power is limited to a tax apportioned to the level of activity actually performed in the jurisdiction. Cities have begun to apply tax ordinances to real estate sales more broadly than before, have begun to treat each independent contractor salesperson as a separate business (thus owing a separate tax) and have begun to utilize aggressive contract collection companies to pursue real estate licensees.

### Current Status

Cities are now hiring municipal auditing companies (MACs) to help them collect delinquent business license taxes (BLTs).

Curtailing the use of the MACs by the cities - by confronting cities with an authoritative legal opinion that using MACs to perform actual tax collections is prohibited by law - may be a best course of action.

The Government Affairs Team at PWR is working hard to defeat business license taxes in many cities. The city of Anaheim agrees with PWR and the REALTORS® that a business license tax is not a solution to generating funds for the city. We hope to move forward on this issues using Anaheim as an example by which other cities may look upon when deciding on this matter.

### Discussion

All cities have as part of their inherent "police" powers the authority to raise revenue by taxing the privilege of doing business within the jurisdiction. Over the years the courts have affirmed that power, so long as the tax levied is properly apportioned to the amount of business activity actually carried out in the jurisdiction. For this reason, a flat fee BLT is inconsistent with the law -- but often not challenged by Realtors® and other businesses because the flat fee is so nominal that any apportioned fee is bound to end up being more expensive and more difficult to comply with.

In order to comply with the law, more progressive cities have sought to assess a tax based upon a business' gross receipts generated within the jurisdiction. Note that simply assessing a multi-jurisdictional business based on its gross receipts is just as legally flawed as imposing a flat fee, unless the gross receipts are those earned *within the jurisdiction*. Unfortunately for cities, any apportionment of activity in a service oriented business like real estate is necessarily arbitrary and hard to validate.

### The Problems

**Multiple Jurisdictions.** If a real estate licensee practices across multiple city boundaries, an inappropriately apportioned tax will tax the same income in multiple places and effectively force the licensee to pay a much higher tax rate. In some urbanized areas a single licensee may practice in (or just pass through) as many as a dozen different jurisdictions, all of which would like to collect a tax.

**"Double" Taxation of Salesperson Commissions.** If a city concludes that an independent contractor is a business separate from an employing or supervising broker, it is encouraged to tax the commission proceeds flowing to the salesperson from the employing broker. If the city does so, these proceeds will

have already been included in the gross receipts attributed to the employing broker prior to the pass-through of the commission split.

**Heavy-Handed Enforcement.** Some cities have attempted to creatively apply existing BLT ordinances to previously untaxed sales activities, and have even sought back taxes and penalties from licensees from whom they never before attempted to collect. The problem has also been worsened by contract (commission based) collection companies that aggressively interpret existing ordinances and apply them as broadly as possible. See "Municipal Auditing Companies," prepared for January 2006, and September 2005 Taxation Committee for additional information.

The only options to change the result in business license rules are to use political power to defeat the tax ordinances at the local level; change the status of real estate practitioners so that they become members of a non-taxable category; or go to state law and change the way the tax itself is applied.

### Options

1. Do Nothing. Existing policy; requires fighting inappropriate taxes at the local level, does not change Realtors cities' authority to tax or the licensees' independent contractor status.
2. "Have our cake and eat it too" - Change the characterization of real estate salespersons and broker associates to that of "employee" for BLT (Business License Tax) purposes, while at the same time preserving the status of "independent contractor" for all other purposes.
3. Business Entity taxation - Prohibit the application of a BLT to a regulated business entity except at the office address(es) shown in the regulatory records of the business.

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# **ATTACHMENT #6**

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November 17, 2008

**VIA FIRST CLASS MAIL**

Jennifer McGrath  
City Attorney  
City of Huntington Beach  
P.O. Box 190  
2000 Main Street  
Huntington Beach, California 92648

RECEIVED

NOV 18 2008

City of Huntington Beach  
City Attorney's Office

Re: Business License Tax

Dear Ms McGrath:

As you are aware, I represent Orange County Association of REALTORS® with regard to addressing the application of the City's business license tax to real estate licensees.

Staff has proposed alternative language and I provided you with my comments concerning the alternative language. From our recent telephone conversation I learned your office is not inclined to accept our suggestions, and after consultation with my client we believe we need to explain why we selected the language contained in our revisions.

Real estate agents are involved in a business that is markedly different from other businesses. The California Business and Professions Code divides the licensing of real estate professionals into two categories: (1) brokers, and (2) salespersons (commonly referred to as agents). In addition, there are those individuals that have obtained a broker's license but chose to work for another broker in the same capacity as a salesperson.

As we have thoroughly discussed with Council, agents cannot work on their own. By law they must be affiliated with a broker and the broker is entirely responsible for the activities of the agent. We also previously produced authorities establishing that agents are considered for most purposes "employees" of the broker and agents of the broker.

We agree with the City that if a broker has an office in Huntington Beach, or operates their principal office through a virtual office in Huntington Beach, the broker should be paying the business license tax. We do not believe agents should pay a business license tax as no other employees of a business having an office in Huntington Beach are required to pay a business license tax.

Your language proposes to require brokers having offices outside Huntington Beach to pay a business license tax when one of its agents shows a home in Huntington Beach. This is unacceptable

THOMAS N. JACOBSON

November 17, 2008

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to the real estate community because the nature of the business will from time to time cause an agent to show a property in a community in which the broker does not have an office. It also attempts to require the payment of the tax when there is no assurance of income on the part of the agent.

Today's real estate industry allows an agent to open up their computer, log into the Multiple Listing Service and view properties throughout Southern California. An agent in the San Fernando Valley has the same access to homes in Huntington Beach as an agent in Newport Beach. A real estate agent can show a listed property in Huntington Beach, but if the prospective buyer does not purchase the property neither the broker nor the agent make any money from the eventual sale of the property in Huntington Beach.

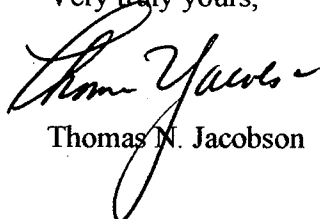
This concept is much different than the normal business model. Most businesses that come into Huntington Beach to transact business have a signed contract, have been paid for goods or services to be provided within the City, or have received an order that results in an obligation owing to the business. Even though an agent may show a property in Huntington Beach there is no obligation to pay compensation until the property actually closes escrow.

If the reaction is to carve out a special tax for real estate brokers that have offices in other jurisdictions and have agents that make sales in Huntington Beach than the City has set up a pattern of discrimination against certain types of businesses, i.e., real estate brokers. The City does not tax businesses that are anchored in other cities and solicit orders by telephone or the web. It does not tax a business that sends its products and services into Huntington Beach when the products or services are ordered on line or on the telephone.

In the traditional business tax scenario the business has set up some physical presence within the jurisdiction, the proceeds of the product or service are delivered within the City and there is some expectation that each transaction will result in a sale. This is not the case with a broker having an office out of the City. In that case, a substantial amount of the work is performed in the office of the broker, the supervision is carried out from the broker's office and the proceeds of the sale are paid to broker in the office outside the City. It is inappropriate to assume the work of making the sale and the sale are consummated in Huntington Beach because in reality the transaction is consummated in the broker's office. To impose the business license tax on the situs of the property is in effect a tax upon the sale of the property and there is no authority in California for imposing such a tax. That same transaction is also going to be subject to the business license tax in which the broker's office is located because that is the place where the actual sales work took place.

I hope you will carefully consider these points and allow us to pursue this further with you.

Very truly yours,



Thomas N. Jacobson